**Summary of Testimony of**
**Chairman James J. Hoecker**
**Federal Energy Regulatory Commission**
**before the**
**Committee on Energy and Natural Resources**
**United States Senate**

**April 27, 2000**

The Federal Energy Regulatory Commission exercises its jurisdiction under the Federal Power Act to facilitate the growing competition in wholesale electric markets. Fair, efficient, and transparent wholesale power markets promise lower prices to consumers and a more efficient allocation of resources. However, concerns remain about how long the transition to competition across the network of high voltage transmission will take. The operation and planning of the grid is not as efficient as it can be and the potential for market power abuses remains. The reliability of the electric power system also is being seriously challenged during this time of transition to more competitive markets. Sound Federal legislation is needed to ensure that competition continues growing and the benefits of this competition accrue to the Nation's electricity consumers. The Commission is prepared to assist the Congress in transforming the interstate electricity marketplace in which there is a strong Federal interest.

In order to allow the Commission to more effectively promote competition, Congress should enact legislation to:

(1) place all electric transmission in the continental United States under the same rules for non-discriminatory open access and comparable service;

(2) reinforce the Commission's authority to foster regional transmission organizations;

(3) establish a system of mandatory reliability rules to protect the integrity of transmission service, relying on a self-regulating organization with appropriate Federal oversight of rule development and enforcement; and,

(4) provide the Commission with appropriate authority to remedy market power.

Balanced electricity legislation should also reform the Public Utility Holding Company Act and clarify Federal/State jurisdiction issues.

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Mr. Chairman and Members of the Committee:

I very much appreciate the invitation to appear here today to discuss the proposed electricity legislation now before this Committee. Permit me to applaud you, Mr. Chairman, and the Committee for focusing attention on the restructuring of the electric power industry, which is a matter of national importance. A timely transition to a competitive, efficient, and reliable wholesale market for electricity is in everyone's interest, whether or not there is retail competition. For that reason, I am pleased to assist Congress in its efforts to bring the benefits of this restructuring to the American people.

The bills before the Committee address a number of critical issues. I urge the Congress to address as many of these matters as it can. However, from the perspective of the Federal Energy Regulatory Commission (FERC), the heart of the restructuring debate at this juncture is the future operation of the interstate transmission grid. It is the strategic asset, the integrated network platform, upon which any competitive and transparent wholesale power market must be built. Interstate bulk power

trade increased dramatically in the 1990s, as electricity demand increased and impediments to market access began to diminish. The entry of new participants in that market, the arrival of e-commerce and new financial instruments, and new technologies will greatly benefit the electricity economy unless competition is thwarted by immature market mechanisms, inefficient transmission network operations, or parochial and discriminatory practices by transmission owners. Electricity competition cannot thrive in a commercial environment with conflicting market rules, congestion, barriers to entry, vertical integration of transmission and generation functions, or declining reliability. The success of any restructuring legislation will ultimately be judged solely on whether it contributes to overcoming these obstacles and achieving good market outcomes.

The Commission has already taken major steps within its authority to make the interstate transmission grid available to all wholesale users and to encourage regional, efficient operation of the transmission grid. Its fundamental regulatory objectives are: (1) to substitute competition for price regulation in wholesale power markets to the extent possible; and (2) to regulate essential transmission facilities so as to enable competition in power markets. If these objectives are effectively met, American consumers will benefit from better prices, a greater selection of services, and enhanced reliability. Because there remain important impediments to the

Commission's work in this area, it is now time for Congress to act.

There are four major areas in which Congress needs to legislate, if we are to achieve and maintain competitive wholesale markets. Legislation is needed to: (1) place all transmission, even if it is publicly-owned or cooperatively-owned, under the same non-discriminatory open access standards; (2) reinforce Commission authority over regional transmission organizations ("RTOs") that will operate the transmission grid on a reliable, regional basis and reduce obstacles to competition among sources of generation; (3) establish mandatory reliability rules to protect the integrity of transmission service, relying on a self-regulating organization with appropriate Federal oversight and enforcement; and (4) enhance the Commission's authority to remedy market power. These actions to promote reliable transmission and competitive wholesale power markets will benefit consumers regardless of policy decisions about opening retail markets to competition.

Today, I want to share with the Committee my observations about the difficulties we seek to solve and how we have approached those problems so far. I will then discuss in detail the legislative actions needed to achieve competitive wholesale power markets, and discuss how the bills pending before you would or would not accomplish that goal.

The Evolving Wholesale Power Market and The Commission's Responses

The dynamic changes now occurring in the structure of the electricity industry flow from one main principle: competitive markets will make better decisions about investments in, and operation of, the electric system and about the consumption of electricity than will either monopoly utilities or regulators. Under such circumstances, some argue that the FERC or the Congress should either abandon the field to economic forces or induce changes in utility behavior with a prodigious donation of ratepayer dollars. I believe a more constructive plan for change is required. The commercial and operational realities of the 20th century electric industry, dominated by monopoly control of the infrastructure and multiple regulatory regimes will sooner or later succumb to fair and unimpeded competition for end-use markets. That competitive environment will require us to create markets and market rules that work.

A more market-driven environment necessitates new rules and governance arrangements to operate the system, better pricing, greater information transparency, appropriate financial incentives, and fewer regulatory restrictions. I believe these developments will eventually reduce or discipline price, maintain a better correlation between supply and demand, ensure reliability, and induce creation of new services and choices.

But, this will be no easy task and there is a high cost associated with delay.

Why does the Commission seek an active role in securing the benefits of competition? The development of new wholesale market mechanisms is, I believe, a matter primarily of Federal interest. In terms of its physical operation and its critical support for the knowledge-based digital economy, the increasingly important wholesale power market is an integrated network of generation resources, system control, and high-voltage transmission that spans the country and all electrical loads. Access to markets is the lifeblood of the increasingly distinct generation sector, which constitutes the single largest investment in the electricity supply chain. Transmission, on the other hand, represents less than 10 percent of the delivered price of electricity. Yet, it is a strategic asset. Fair and comparable access to this grid of essential bulk power transmission facilities is a prerequisite to other pro-competitive developments. Wholesale competition has depended, and will continue to depend, on the ability of buyers and sellers of power to reach each other over the transmission grid. Markets cannot work if buyers and sellers are unable to trade readily over the wires.

The Energy Policy Act of 1992 and the Order No. 888 open access transmission rule were important but not sufficient steps toward competition. They addressed the unwillingness of

transmission owners to volunteer to give other market participants comparable access to the grid. However, they did not fully open transmission reserved for native load or the transmission of non-public utility entities. At a time when we would not tolerate the ownership and control of the Internet or the interstate highway system by entities with incentives to deny or restrict use of those networks by others, there is no reason to allow transmission to be controlled in that fashion. There is even less reason to delegate standard setting and oversight of parts of these interstate networks to entities or jurisdictions that could enforce different sets of commercial rules on their use. To the contrary, the new electricity economy and the grid upon which it is based promise to deliver more power reliably across state boundaries for the benefit of all consumers, whether they live in open access states or not, provided the system is efficiently operated under reasonably consistent rules across entire regions of the country.

Fundamentally, Mr. Chairman, the case I wish to make for Federal legislation and my request for the support of the Committee are founded on my belief that the FERC is prepared and well-situated to assist in this transformation of the wholesale power market. Let me be clear. With the limited exception of ensuring comparable access over the interstate transmission grid, we do not seek to extend our authority to the retail arena, which is the bulk of industry activity and investment. That market is

properly overseen by states. I see a key ongoing role for the Commission in ensuring workable wholesale market structures and foiling the exercise of market power. That role will translate into less need for our traditional command and control regulation as markets become truly competitive.

> The movement toward less regulation and more reliance upon market processes in the electricity industry has enormous potential benefits, and also potential risks. A move toward deregulation that does not take the issue of market power seriously can undermine the goals of industry restructuring and even, as in the case of England, produce a regulatory backlash. Any restructuring initiative must recognize that the lack of economic storage and of price-responsive demand can produce serious market disruptions. Furthermore, levels of transmission capacity that may have been adequate under regulation may not be able to support effective competition. [Borenstein & Bushnell, "Electric Restructuring: Deregulation or Reregulation?," February 2000.]

In sum, the Congress and the Commission must work together to accelerate the arrival of competition and to meet its challenges. To paraphrase Gene Kranz of NASA, failure is not an option. I submit to you that a prolonged transition will serve short-term economic interests of a few at the expense of the American electricity consumers. It will affect reliability. It will impose costs without benefits. It will not lead to the expansion or upgrade of the transmission system. Until wholesale markets are more transparent and competitive, the transition will continue to create huge winners and losers among suppliers of electricity.

**Major Commission Initiatives**

Two major Commission initiatives have sought to increase competition and bring more efficient, lower cost power to the Nation's electricity consumers. The Commission's transmission open access rule known as Order No. 888 has made transmission services available to wholesale sellers and buyers of power that need access to markets over the interstate transmission grid, to the extent the Commission possesses authority over the Nation's grid. The Commission's second initiative, Order No. 2000 issued on December 20, 1999, is designed to help create workable and barrier-free bulk power market structures through formation of regional transmission organizations, or "RTOs." RTOs would operate the transmission grid on a regional basis and reduce obstacles to competition among sources of electric generation.

**Open Access to All Transmission Facilities**

Despite the successes of Order No. 888 in fostering competition, the Commission's open access transmission regime has key gaps. Sections 205 and 206 of the FPA, the basis for Order No. 888's open access requirements, apply to public utilities but not to Federal power marketing administrations, municipal utilities, or those rural electric cooperatives financed by the Rural Utilities Service ("non-public utilities"). A number of these non-public utilities own or control substantial amounts of transmission facilities. While the Commission has limited authority under FPA section 211 to require these entities to

provide transmission service, the process is slow and cumbersome, and is administered on a case-by-case basis.

Because our jurisdiction over non-public utility transmission-owning entities is limited, approximately one-third of the Nation's integrated transmission grid is beyond the reach of Order No. 888's open access requirements. In virtually all cases, however, the transmission facilities owned by the non-public utilities are integrated with, and are affected by, jurisdictional transmission operations. While I am pleased to say that a number of non-public utilities such as the Bonneville Power Administration (BPA) and the Western Area Power Administration (WAPA) have voluntarily offered transmission service under FERC-approved open access tariffs, many others have not. In any event, we are in no position to ensure continuance of such pro-competitive arrangements.

Efficient markets in network industries generally require that all service providers within an economic market be subject to the same rules. The gap in the applicability of open access transmission rules on the interstate grid may preclude customers from reaching lower cost power sources.

While some have argued that many public power or electric power cooperatives do not have transmission that is valuable to the grid or that has been the subject of access inquiries or complaints, this misses the fundamental point that only a change in Federal law can ensure the availability of open access

transmission service over all transmission systems, if and when it is needed to support competitive power markets. However, such legislation need not intrude unnecessarily into the activities of public power-type entities.

I believe that simplified procedures can be designed to ensure that cooperatives and public power entities whose delivery facilities are not part of the integrated transmission grid are not overly burdened in obtaining exemptions from our regulatory requirements. I see merit to the general type of process that was described in H.R. 2944, i.e., where a small cooperative or public power entity could self-certify that it owned no facilities that occasioned jurisdiction. The Commission can develop these types of exemptions administratively. Moreover, the experience of those non-public utilities that have voluntarily adopted open access tariffs demonstrates that open access service consistent with the Commission's requirements is as workable for non-public utilities as for public utilities, although appropriate legislation may be needed to address related tax consequences in certain cases. As I note below, several bills would address these issues by extending FPA jurisdiction over the rates, terms and conditions for transmission services provided by non-public utilities that own, operate, or control transmission facilities.

**Regional Transmission Organizations**

Under current conditions, even with Order No. 888 in effect, the operation and planning of the Nation's transmission grid will differ utility to utility, state to state, and region to region. These differences constitute commercial and engineering obstacles to greater competition and efficiencies in our electric power system. Among the many transmission owners and operators, there is only limited coordination. The reliability rules under which they operate are voluntary and increasingly subject to challenge. Transmission planning and expansion are becoming more inadequate and uncertain as the number and distance of unbundled transactions increase. The reliability of the Nation's bulk power system is stressed by the growing number of transactions, the large number of transmission owners, and numerous separate control areas. In addition, pancaked transmission rates (i.e., additive rates to move power across multiple transmission systems) hurt consumers that pay higher transmission rates and have access to fewer generation supply options.

The Commission recently issued a new rule -- Order No. 2000 -- to address these problems by facilitating the voluntary, rapid formation of RTOs. In brief, an RTO is an electric transmission system operator that is independent from power market participants and is responsible for providing reliable, efficient, and non-discriminatory transmission service in an

entire region. Under Order No. 2000, RTOs may be formed as independent system operators, or ISOs, which are regional entities that operate transmission facilities owned by others; independent transmission-only companies (transcos) that both own and operate a regional transmission system; or some combination of organizational forms.

Order No. 2000 does not require public utilities to participate in an RTO, but encourages such participation by setting out clear standards, prescribing filing requirements, and making innovative transmission rate treatments available to those who participate. The rule also sponsors a collaborative process for transmission-owning entities to participate in the formation of RTO proposals. The Commission has recently completed a series of five kick-off workshops held in selected locations across the country. These workshops, which were run by senior Commission staff as facilitators of a dialogue among all interested industry participants, had pragmatic agendas designed to foster RTO planning and implementation. In each workshop, regional participants established a strategic process which will lead to further collaboration and, in most regions, the development of RTO proposals by the October 15 deadline in the rule. I have committed to furnishing whatever technical Commission staff resources the market participants may need for this process.

If properly constituted and truly independent, RTOs can help address and eliminate remaining obstacles to competition and make

the markets more efficient, for the benefit of electricity consumers in all States. Indeed, RTOs support wholesale competition and, where states choose to pursue it, retail competition. But even in the absence of retail competition, consumers will benefit from increased competition in wholesale markets. First, RTOs can be structured to eliminate "pancaking" of transmission rates that raises the cost of moving power across multiple utility systems. Second, RTOs that have the proper tools can better manage transmission congestion, reduce the instances when power flows on transmission lines must be decreased to prevent overloads, and effectively solve short-term reliability problems. I believe that RTOs will attract the capital and expertise needed to expand the grid and serve the generation capacity necessary for the growing and competitive electricity markets. Third, RTOs will ensure that vertically-integrated transmission-owning utilities do not discriminate in favor of their own generation over another seller's generation. Fourth, RTOs can facilitate transmission planning across a multi-State region and, by operating the grid as efficiently as possible, may give confidence to State siting authorities that new transmission facilities are proposed only when truly needed. Significantly, the Commission is prepared to defer to the planning, operation, and control area decisions of an RTO if it fairly represents the interests of all stakeholders through open membership and fair governance procedures.

**Legislative Priorities for Wholesale Electric Markets**

To achieve benefits for the Nation's electricity consumers and to fully realize the goal of competitive wholesale power markets set by Congress in the Energy Policy Act of 1992 and promoted by the Commission since then, I believe that Federal electricity legislation should, at a minimum: (1) bring all transmission facilities in the lower 48 States under the Commission's open access transmission authority; (2) reinforce the Commission's authority to promote regional management of the transmission grid through regional transmission organizations; (3) establish a fair and effective program to protect bulk power reliability; and (4) enhance the Commission's authority to remedy market power where existing remedial tools are insufficient. It would also be very helpful to clarify certain jurisdictional issues under the Federal Power Act (FPA) and amend the Public Utility Holding Company Act (PUHCA) to foster competition and allow the Commission and States to protect consumers against affiliate abuse and cross-subsidization. Such legislation would help the Commission remove impediments to market competition by providing increased open access to transmission, encouraging efficient and reliable regional transmission operations, and clarifying the jurisdictional issues that are bound to arise as industries change fundamentally.

In recommending these legislative priorities, I would like to stress that my focus is primarily on competitive and operational issues surrounding the interstate transmission system. States will continue to have an important regulatory role in emerging markets, and the establishment of an open interstate transmission grid and competitive wholesale power markets will accommodate states and provide benefits to their retail consumers, whether or not they choose to adopt retail choice programs.

**RTO Authority**

While the Commission has adopted a voluntary approach to RTO formation, it also has concluded that it has the authority under sections 205 and 206 of the FPA to order public utilities to participate in RTOs on a case-by-case basis, if necessary to remedy undue discrimination or anticompetitive effects. Because the FPA is not express in this regard, it is important that this authority be reinforced. I support legislation that makes clear the Commission's authority with respect to RTO formation. Specifically, I support legislation that would reinforce the Commission's authority to order public utilities to establish and participate in RTOs, if the voluntary approach does not work. I also support legislation that expressly authorizes the Commission to require non-public utilities to participate in RTOs, and clarifies the authority of Federal transmitting utilities (Tennessee Valley Authority, Bonneville Power Authority,

Southwestern Power Administration, and Western Area Power Administration) to participate in RTOs. Such legislation would assist the Commission in developing efficient and reliable regional power markets in the interest of lower cost power and high reliability.

**Reliability**

Let me turn next to the issue of reliability. In the past, regulators and industry participants relied upon voluntary industry cooperation to establish reliability standards and practices. Regional reliability councils and the North American Electric Reliability Council (NERC), comprised primarily of transmission-owning utilities, relied upon voluntary cooperation and peer pressure to ensure compliance with the standards they established.

Competition in power markets has increased concern that reliability rules can no longer be set or enforced in the same voluntary manner as in the past. Power markets today have many more participants and transactions. Faced with competitive pressure, some participants may be prompted to cut corners on reliability. Many observers, including NERC and the industry itself, have concluded that a system of mandatory reliability rules is needed to ensure that competition does not compromise the security of our Nation's electric transmission system. Federal legislation is needed to achieve this end. I believe

that appropriate reliability legislation is critical to a well-functioning industry and that the consensus legislation sponsored by NERC and included in many of the bills pending before you contains the fundamental elements of sound legislation in this area.

Congress should understand, however, that mandatory reliability rules are not enough to ensure the reliability of the grid. In addition, the market rules must elicit sufficient investment in new generation and transmission facilities. In the natural gas industry, for example, reliability is fostered in the first instance by market rules that elicit investment in the production and transportation of the commodity. In the electric industry, we can achieve the same result by ensuring that generators can get their power to as many customers as possible and that transmission owners have the incentives to meet the needs of transmission users. My recommendations above on open access and RTOs support this goal.

An important State-Federal issue has arisen in the context of the debate on reliability legislation: the appropriate role of States in protecting reliability of service to consumers and the role of the Commission in protecting the integrity of the bulk power transmission system and ensuring that all transmission users are served by the interstate grid on a non-discriminatory basis.

Jurisdictional issues should not be allowed to obscure the need for a new enforcement system. There are important policy and operational issues that must be addressed. The transmission grid is increasingly being used for transactions that, either contractually or because of the laws of physics affecting the flow of electrons, cross State (and even international) borders. This has increased concern that a mandatory reliability mechanism must be developed to ensure that these interstate transactions do not compromise the transmission grid or the quality of service. This is a fundamental issue of interstate commerce. The Nation's need for a reliable transmission grid ought to prevail over the current jurisdictional disagreements. While State and local authorities legitimately want to protect retail consumers within their particular States, there is also a significant Federal interest in protecting reliability and fair commerce across State borders. I am confident that legislation can be developed to address both Federal and State concerns.

**Market Power Remedies**

As we seek to rely more heavily on competition as opposed to traditional price regulation to protect the interests of consumers, regulators must have the range of tools necessary to address market power problems that threaten competition. Currently, the Commission has only limited remedies available to address market power problems. The Commission can prevent

enhancement of market power when utility mergers or other corporate transactions require authorization under FPA section 203. This remedy does not address market power that is already built into current commercial and operational arrangements, however. The Commission also can deny or revoke authorization for market-based wholesale rates. Again, when this approach is employed to reimpose cost-based rates, the Commission does little or nothing to promote competition. In addition, while the Commission has stated that it believes that it has the authority to order public utilities to participate in RTOs where necessary to remedy undue discrimination or anticompetitive effects, as I indicated earlier, this authority should be clarified and reinforced.

Remedial authority such as that contained in the Administration's bill would allow us to ensure fair wholesale competition and expand the Commission's use of light-handed regulation of the wholesale commodity. Reforms to the Federal statutory scheme are appropriate to permit regulators to keep up with the challenges posed by market power in evolving markets. Without such reforms, and without adequate remedial authority, market power could be used to impair competition and the related benefits to consumers. For example, the Administration's bill would clarify that the Commission has jurisdiction over mergers involving only generation facilities, and that holding companies with electric utility subsidiaries cannot merge without

Commission authorization. It also would allow us to address market power outside the context of mergers. For example, it would allow the Commission to address market power in retail markets, if asked to do so by a state lacking adequate authority to address the problem. Such authority would be consistent with the Commission's policy of addressing a merger's effect on retail competition when states request Commission action and cite their own lack of authority.

The Administration's bill would also give the Commission explicit authority to address market power in wholesale markets by requiring a public utility to file and implement a market power mitigation plan. I believe it would be helpful to close these gaps in the Commission's jurisdiction over mergers and remedial authority to safeguard against market power.

**Clarifying Federal/State Jurisdiction**

There are important clarifications of State/Federal jurisdiction that should be addressed in legislation. The issue of Federal/State jurisdiction has arisen because of changes in markets that have invalidated many old assumptions and practices. No one wishes to avoid a frustrating "turf battle" between Federal and certain State authorities more than I. I simply urge the Committee to gauge the appropriate policy according to the likely market outcome. Regulatory authority, in my view, should be allocated according to how best to ensure that all electric

consumers are served fairly and efficiently. The transmission grid is now being used for vastly more transactions, for transactions over greater distances, and for more transactions that cross multiple State borders. This raises not only the reliability concerns discussed earlier but also the need for uniformity and transparency in transmission services offered on the interstate grid. Without these attributes, transmission service will be incapable of bringing buyers and sellers to one another readily, economically and without unduly discriminatory treatment.

The Congress should ensure an appropriate division of authority between State and Federal regulators to provide greater regulatory certainty as electricity markets become more competitive. In the absence of Congressional action to update jurisdiction, these important decisions will be left to courts attempting to reconcile 65 years of practice developed for a smaller, more balkanized and non-competitive wholesale market, with the dynamic competitive market that is transforming the industry today.

First, Congress should clarify the authority of the States to order retail access. While many States have gone forward with retail customer choice programs, utilities challenging such initiatives have argued that the FPA preempts States from ordering retail access. While I do not subscribe to that view, if such arguments were to prevail, they could effectively thwart

pro-competitive innovation at the State level. Congress should remove this legal cloud.

Second, the Congress should clarify that the Commission has authority over facilities used for unbundled retail transmission in interstate commerce, (i.e., interstate transmission used to accommodate retail choice programs) and that the States have authority over local distribution facilities and services. Some states, through NARUC, seek control of transmission heretofore dedicated to native load (i.e., those customers that receive state-regulated retail service) and traditionally billed as part of a retail service. A grant of this control, along with the control of transmission by non-public utilities, would effectively restrict the application of open access and competition to a very small part of the grid and narrow competitive wholesale markets tremendously. Congress must ensure that the law does not permit this result.

The Commission should have jurisdiction not only over the rates, terms and conditions of interstate transmission used for wholesale sales but also over the rates, terms and conditions of interstate transmission used for unbundled retail sales. This approach supports truly competitive power markets and ensures both that all unbundled transmission is subject to the same nondiscriminatory standards and that balkanized markets do not result. Otherwise, parochial State interests could interfere

with interstate transmission and thwart the development of competitive and seamless bulk power markets.

The Congress also should clarify that the Commission, after consultation with and deference to the States, can determine the jurisdictional split between transmission and local distribution facilities on a case-by-case basis. Legislation to clarify this split, avoid regulatory conflict, and help provide certainty to utilities as to which regulator has jurisdiction over which facilities would be very useful.

Let me emphasize, in any event, that States must be assured control over local distribution to consumers within their borders and appropriate jurisdictional means, such as local distribution service charges, to structure and assess fees designed to recover stranded costs and stranded benefits, that is, if State and local policymakers decide it is appropriate to do so. Conversely, it is inadvisable to assign to States the authority to unnecessarily impede interstate commerce in electricity or cause undue discrimination against customers in other states, in the name of protecting bundled retail customers or local distribution. That would have uneconomic and anticompetitive consequences.

A recent appellate court decision illustrates perfectly why we have concerns about the ability of the Commission to ensure non-discriminatory transmission access if States retain authority over bundled retail transmission. Northern States Power Co. v. FERC, 176 F.3d 1090 (8th Cir. 1999) (NSP), if interpreted and

applied broadly, could allow the States to establish preferential terms and conditions for the bundled transmission services they regulate compared to the terms and conditions available to other transmission users. In effect, one State could set rules for the use of interstate transmission to favor electric consumers in its state to the detriment of electric consumers in another State. I recommend that the Committee either must: (1) be clear that states are preempted from using jurisdiction over bundled retail transmission to discriminate against customers in other states or to interfere with interstate bulk power markets; or (2) establish FPA jurisdiction over all transmission, including bundled retail transmission, to ensure universal comparability and non-discrimination in the provision of transmission services in interstate commerce. If, however, the Congress decides to allow States the jurisdiction over bundled retail transmission, I urge it to add the following provision to FPA Section 201(a):

> "In regulating the transmission of electric energy under any provision of this part [Part II of the FPA], the Commission shall have exclusive authority to establish rates, terms and conditions of transmission service that are just, reasonable and not unduly discriminatory or preferential, including rates, terms and conditions that prevent or eliminate undue discrimination or preference associated with a public utility's or transmitting utility's

own uses of its transmission system to serve its wholesale and retail electric energy customers."

The Congress also should clarify that, if States order retail customer choice programs, the Commission has the authority to order whatever transmission service is necessary to move the power from the seller, across intervening States, to the ultimate State that has the retail choice program. This will require an amendment to section 212(h) of the FPA, which otherwise could be construed in some circumstances as precluding the Commission from ordering transmission to accommodate State retail customer choice programs.

Lastly, you heard two weeks ago that the issue of whether we should have jurisdiction over bundled transmission is a transitional issue that will eventually be resolved as the result of the spread of RTOs and state consumer choice legislation. This assumes that the courts do not explicitly overturn our current interpretation of the Federal Power Act. However, this suggestion neglects the consequences of waiting for time to take its course. In the interim, there would continue to be gaps in the Nation's transmission grid that are subject to dual regulation and there would continue to be litigation over the related issues, for example, whether retail load served under the ISO format rather than the transco format has, indeed, been unbundled. The industry needs clarity on these issues as soon as

possible or the transition to competitive markets will be delayed and impaired.

**PUHCA Reform**

PUHCA requires some utilities to comply with restrictions that are not compatible with bulk power competition. Additionally, in some instances, PUHCA encourages concentrations of generation ownership and control in local markets that are inconsistent with competition and discourages asset combinations that could be pro-competitive. Thus, PUHCA should be amended or repealed, with one major caveat. Reform legislation should ensure that both the Commission and States have adequate access to the books and records of utilities and their affiliates, to protect against affiliate abuse and ensure that captive consumers do not cross-subsidize entrepreneurial ventures. Also, if PUHCA is not repealed, it should be amended to restore FERC's ability to adequately regulate the rates of utilities that are members of registered holding company systems, closing the regulatory gap created by the court decision in Ohio Power Co. v. FERC, 954 F.2d 779 (D.C. Cir. 1992).

## Pending Legislation

I now turn to the eight bills that are pending before this Committee and that are the subject of this hearing. The Administration's bill, S. 1047, appropriately addresses the issues that I have identified as critical to establishing a

competitive wholesale power market. Senator Bingaman's bill, S. 1273, also goes a long way toward producing the best wholesale market outcomes. The bill introduced by Senators Murkowski and Landrieu, S. 2098, is helpful in a number of respects but I believe its RTO provisions may prevent the Commission from pursuing fair, efficient, and transparent bulk power markets through the formation of RTOs. The remaining five bills being discussed today also fail to address some critical issues or contain provisions that, in my estimation, will inhibit important pro-competitive developments such as the formation of RTOs. I will comment primarily on the elements of these bills that affect the major activities within the Commission's current jurisdiction – transmission and wholesale sales of electric energy in interstate commerce. While I would be pleased to provide the Committee with detailed technical comments on each bill if the Committee requests, I will comment more generally on each bill today.

**S. 2098** (introduced by Senators Murkowski and Landrieu)

S. 2098 authorizes transmitting utilities to apply to the Commission to create, implement, or participate in RTOs and directs the Commission to approve such applications when it finds that they comply with eight specified standards. Unfortunately, this provision arguably diminishes current authority under the FPA to take certain actions to cure undue discrimination in the

provision of service by transmission-owning public utilities, and also leaves the Commission without tools to provide for RTO participation by public or cooperatively-owned transmitting utilities. The Commission in its RTO rule concluded that it currently has the authority to require RTO participation by public utilities, i.e., primarily traditional investor-owned utilities, where there is a record of undue discrimination or where it is necessary to remedy anticompetitive effects. S. 2098 should be amended to reinforce this authority and to provide the same authority with respect to non-public utilities (e.g., public power entities).

The RTO provision in S. 2098 further applies restrictive standards for analyzing RTOs, which may or may not be the appropriate criteria for future RTOs as the industry evolves. For example, it contains a presumption that ownership of 5% of the voting interests in an RTO does not convey control over the RTO. I do not recommend that Congress legislate such rigid criteria which may be inconsistent with competitive wholesale power markets of the future.

S. 2098 amends the FPA to provide Federal eminent domain authority for new transmission lines when proposed in accordance with a regional planning process. I believe that this would ease the way for additional investment in the transmission grid and increase the likelihood of the transmission grid operating near its optimal level. While I recognize that such an amendment

might be controversial, I would note that Federal eminent domain authority already exists under the Natural Gas Act and that the Commission has had years of substantial experience siting natural gas pipelines. Similar steps to remove obstacles to transmission siting may be needed as the transmission grid is used for a growing number of interstate bulk power transactions.

Nevertheless, Federal eminent domain represents a very strong limitation on current state authority. I therefore support as more palatable a general approach that would allow the Commission to facilitate the siting of critical facilities and would provide for a more direct Federal role where states are deadlocked or decisions are otherwise stymied. My hope is that RTOs can facilitate regional planning of, and support for, transmission expansions and thus avoid or reduce the need to rely on the type of Federal authority contained in S. 2098.

S. 2098 repeals the requirement in PURPA that electric utilities must purchase electricity from qualifying facilities, but does so prospectively only. It does not affect rights and remedies under existing contracts. Assuming an increasingly competitive environment, I agree that it is unreasonable to impose a "mandatory purchase" requirement. However, I recommend that the provision in the bill be clarified so as not to preclude voluntary buy-outs or buy-downs of uneconomic PURPA contracts where appropriate.

S. 2098 allows transmission users to obtain open access transmission services over the facilities of non-public utilities in interstate commerce. S. 2098 also provides for establishment of mandatory reliability rules, developed by a self-regulating organization with appropriate Federal oversight of rule development and enforcement. As I stated above, these are important goals. However, the provision in S. 2098 that sets forth the reliability role of State and local authorities (state savings clause) is written too broadly. It would not protect the national interest in preserving the reliability of the interstate grid, which serves customers in multiple states, and would likely lead to conflicts between neighboring states.

S. 2098 repeals PUHCA, but amends the FPA to provide the Commission and State commissions with access to needed holding company (and affiliate) books and records. As I testified above, this access to books and records is an essential corollary to the repeal of PUHCA.

S. 2098 does not give the Commission additional tools for addressing market power. For reasons I described above, the Commission needs these tools to ensure effective competition in wholesale markets and, upon request by State authorities, in retail markets.

**S. 1047** (Administration's bill)

S. 1047, the non-tax portions of the Administration's proposed restructuring bill, constitutes a comprehensive legislative proposal. I believe the bill provides an excellent framework for Federal electricity legislation.

For example, the bill would bring all transmission facilities in the lower 48 States within the Commission's open access transmission rules by extending FPA section 205 and 206 jurisdiction over transmission services provided by Federal, municipal and cooperatively-owned utilities.

S. 1047 would reinforce FPA authority to promote regional management of the transmission grid through regional transmission organizations. It would amend FPA section 202 to expressly permit the Commission to establish an entity for independent regional operation, planning, and control of interconnected transmission facilities and to require a utility to relinquish control over operation of its transmission facilities to an independent regional system operator. I interpret the bill's reference to "entities for the purpose of independent operation, planning and control" of transmission facilities as not precluding transcos or other forms of regional transmission organizations. It would nevertheless be helpful to have this clarified. Appropriately, however, before taking such action, the Commission would have to find, among other things, that: the

action is appropriate to promote competitive electricity markets and efficient, economical, and reliable operation of the interstate transmission grid; the utility transferring control of its transmission facilities will receive just and reasonable compensation; and adequate reliability of the facilities will be maintained. These preconditions should address the legitimate concerns of the transmitting utilities.

S. 1047 would address electric reliability by amending the FPA to give the Commission the authority to approve and oversee an Electric Reliability Organization tasked with developing mandatory reliability standards. The bill provides that: (1) the reliability rules will be mandatory and will be enforceable; (2) the industry-based process for developing new standards will be open; and (3) the Commission will have an appropriate oversight role to ensure that the reliability standards are sufficient to preserve reliability and are non-discriminatory, but will defer as appropriate to the technical expertise and stakeholder process of the industry organization. This approach strikes an appropriate policy balance.

As to merger review, the bill would clarify FPA jurisdiction over the merger or consolidation of electric utility holding companies and generation-only companies. These reforms would help guard against gaps in FPA merger review.

Further, the bill would authorize the Commission, upon petition from a State, to remedy market power in retail markets.

It also would amend the FPA to authorize the Commission to remedy market power in wholesale markets outside the context of merger review. As market-based rates become more widespread, the ability to structurally remedy horizontal market power in generation markets, especially where transmission constraints limit the number of market participants, becomes even more important. Providing a Federal backstop to address market power where States have identified, but cannot remedy, a market power problem would support States seeking to pursue retail competition policies.

I believe these provisions, taken together, address the major areas in which further legislation is needed to move us to fully competitive wholesale power markets and to support States that choose to develop retail competitive power markets.

**S. 282** (introduced by Senators Mack and Graham)

S. 282 repeals, prospectively, the existing requirement found in the Public Utility Regulatory Policies Act (PURPA) that electric utilities must purchase power from qualifying facilities. It does not interfere with existing contracts or affect existing obligations. S. 282 requires the Commission to promulgate regulations that ensure that utilities may pass through, and not be required directly or indirectly to absorb, the stranded costs associated with purchases from qualifying facilities under contracts existing before the date of enactment.

As competitive bulk power markets have emerged, contracts entered into in prior years under PURPA have become uneconomic because they contain, as a result of PURPA, rates that are above current market prices. In this increasingly competitive environment, it is unreasonable to impose a "mandatory purchase" requirement that could result in sales of power at an above-market price. S. 282 recognizes the changes in competitive markets by repealing the mandatory purchase obligation prospectively. Importantly, it does not interfere with existing contracts. However, I recommend that it be clarified not to preclude utilities from buying out or buying down high-cost PURPA contracts where appropriate. I personally believe that repeal of this PURPA provision should be accompanied by reasonable legislation to support renewable energy resources.

**S. 516** (introduced by Senator Thomas)

Among other changes, S. 516 would deregulate the prices for sales of electricity at wholesale, exempting the rates for such sales from Commission regulation under Parts II and III of the FPA. Deregulated prices can be justified only where the seller lacks or has mitigated market power. While the Commission has allowed market-based rates for the vast majority of public utilities, many of these utilities own monopoly transmission facilities and at this time the Commission is persuaded it must continue to monitor for the exercise of market power and

affiliate abuse. Also, transmission constraints can limit the ability of new competitors to sell power into certain areas and allow sellers already within such areas to exercise market power. In instances where markets are not working or when there are instances of affiliate abuse, the Commission needs continued authority to regulate wholesale power rates. Without FPA authority to regulate wholesale rates, bulk power purchasers could face costly price increases where conditions do not permit competition, and these increases, in turn, would likely be passed through to consumers.

S. 516 would place all entities that own, operate or control facilities used for the transmission of electricity in interstate commerce under FPA section 205 and 206 jurisdiction with respect to wholesale transmission service. As stated earlier, I believe that it is vitally important to place all owners of transmission facilities in the integrated grid under the same open access rules.

S. 516 also provides for establishment of mandatory reliability rules, developed by a self-regulating organization with appropriate Federal oversight of rule development and enforcement. As I stated above, these are important goals. However, the provision in S. 516 relating to the reliability role of State and local authorities (state savings clause) is written too broadly. It would not protect the national interest in preserving the reliability of the interstate grid, which serves

customers in multiple states, and would likely lead to conflicts between neighboring states.

S. 516 does not address two other areas in which I believe legislation is needed: RTOs or market power mitigation. As I described above, the Congress should address these areas to ensure that consumers receive the full benefits of competition.

**S. 1273** (introduced by Senator Bingaman)

Consistent with some of the bills discussed above, S. 1273 extends section 205 regulation of transmission service to PMAs, TVA, municipal utilities, and cooperatives still owing debt to the Rural Utilities Service. This amendment would fill the gaps in the availability of open access transmission service nationwide, and thus allow customers to receive the full benefits of competitive bulk power markets. S. 1273 amends the FPA to allow the Commission to order transmission service to ultimate consumers where the seller is permitted or required by State law to make such sales. S. 1273 further amends the FPA to allow States to require electric utilities to provide unbundled local distribution service on a not unduly discriminatory basis. These amendments provide important clarifications of Commission and State authorities.

S. 1273 would amend the FPA to authorize the Commission to order the formation of "regional transmission systems," and to order transmitting utilities within such regions to participate.

The bill would authorize the Commission to appoint an oversight board (composed of a fair representation of all of the transmitting utilities participating in the regional transmission system, electric utilities and consumers served by the system, and State regulatory authorities within the region) to oversee the operation of the regional transmission system and to ensure that the independent system operator formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner. S. 1273 also provides for the oversight board to appoint an independent system operator to operate the regional transmission system. I interpret this provision as not precluding transcos or other forms of regional transmission organizations. This operator is not permitted to own generating facilities or sell electricity, and may not be subject to the control of, or have a financial interest in, any utility with the region.

The Commission believes it is essential to form regional grid management institutions that provide for independent, regional operation of the grid. All transmission facilities in a region should be under the control of a single, independent operator. I understand S. 1273 to promote goals and mechanisms similar to Order No. 2000. However, I do not believe that legislation should dictate the organizational form of these new institutions. Rather, there should be flexibility for ISOs,

transcos, combinations of the two, or other forms or organization.

S. 1273 contains a reliability provision directing the Commission to establish and enforce national electric reliability standards, and permitting the Commission to designate regional councils and one national council. This provision, while less detailed than the reliability provision contained in other bills, adequately meets the needs for fundamental reliability legislation.

S. 1273 amends the FPA to provide for Federal siting of new transmission facilities. The bill also would authorize the Commission, when necessary or desirable in the public interest, to order utilities to enlarge or improve their existing facilities (unless doing so would unreasonably impair the ability to render adequate service). Before issuing such an order, the Commission would need to comply with the requirements of the National Environmental Policy Act, and would need to refer the matter to a joint FERC/State board for advice and recommendations on the need, design, and location of the proposed facilities.

The construction of new transmission facilities represents an important means of obtaining the efficiency benefits of greater electricity competition in many circumstances. The construction of new facilities may also have reliability benefits for the State or locale in which the facilities are located and other States and locales as well. At present, State-by-State

planning and siting are the norm. However, as new transmission facilities are used increasingly to support regional reliability and markets, States may have difficulty balancing local impacts with broader, regional benefits.

I believe the answer to this dilemma rests with creation of institutions that have a regional perspective on the planning and development of new facilities, and that take into account the interests of all affected market participants and States. This type of institution could adopt a broad perspective on decision making on proposed transmission expansions and fairly balance local and regional concerns and benefits, as well as the suitability of constructing new transmission facilities compared, for example, to developing new generation. RTOs could perform this planning function, recognizing that their role would only be advisory to State siting authorities under existing law. However, as I stated in my comments on S. 2098, I believe that some steps to remove obstacles to transmission siting may be needed because the transmission grid is carrying a much larger number of interstate bulk power transactions. I support a general approach that would allow the Commission to facilitate the siting of critical facilities and would provide for a more direct Federal role where States are deadlocked or siting decisions are otherwise stymied.

**S. 1284** (introduced by Senator Nickles)

S. 1284 would repeal PUHCA. As I testified above, I believe any repeal of PUHCA must be accompanied by a grant of additional authority to FERC and State commissions to access needed holding company (and affiliate) books and records.

S. 1284 repeals the requirement in PURPA that electric utilities must purchase electricity from qualifying facilities, but does so prospectively only. It does not affect rights and remedies under existing contracts. As I noted above, in this increasingly competitive environment, it is unreasonable to impose a "mandatory purchase" requirement at anything other than the market price.

**S. 1369** (introduced by Senator Jeffords)

S. 1369 requires the Secretary of Energy to establish a National Electric System Public Benefits Board, which will include a representative from the Commission. The Board is required to establish an account, funded by a Commission-established nonbypassable wires charge, that is to provide matching funds to States for the support of State public purpose programs.

S. 1369 also provides that non-hydroelectric generation facilities must use an increasing percentage of renewable energy sources in generating electricity. The bill requires the Commission to establish standards and procedures under which generation facilities certify their use of renewable energy

sources. It also requires the Commission to establish a system of renewable energy credits.

I generally support mechanisms to encourage renewable energy resources, so long as they are consistent with competitive wholesale energy markets and do not impede fair access to interstate transmission.

S. 1369 requires electric companies to allow a retail electric customer to interconnect and employ a net metering system that measures the difference between the quantity of electricity supplied by an electric company to a customer-generator and the quantity generated by a customer-generator and fed back to the electric company. S. 1369 requires the Commission to adopt rules on electrical safety, power quality and interconnections for net metering systems that use non-photovoltaic generation. Interconnection to the transmission grid on a non-discriminatory basis is necessary to eliminate barriers to competitive power markets and I support provisions that facilitate such access.

**S. 2071** (introduced by Senator Gorton)

S. 2071 addresses electric reliability in essentially the same manner as S. 2098 and S. 1047. It would, among other things, amend the FPA to give the Commission the authority to approve and oversee an Electric Reliability Organization tasked with developing mandatory reliability standards. The approach

taken in S. 2071 strikes an appropriate policy balance, as I indicated with respect to the reliability provisions of S. 2098 and S. 1047.

Reliability is of fundamental importance and I therefore clearly understand why stand-alone legislation on this subject is attractive. The Commission is prepared to implement such legislation if enacted. Reliable electric service will require more than an effective standard-setting and enforcement mechanism, however. It will require workable markets and the Congress must assist that effort as well.

## Conclusion

Thank you again for the opportunity to offer my views here this morning. I emphasize that my comments on specific bills have focused primarily on provisions that may affect the Commission's responsibilities and have discussed only the general approaches in the bills. I would be happy to provide technical comments in the future if it would be helpful to the Committee. I would be pleased to answer any questions you may have.